Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Message Text

PAGE 01 STATE 262351
ORIGIN TRSE-00

INFO OCT-01 ARA-10 ISO-00 EB-08 AGRE-00 CIAE-00 INR-07
NSAE-00 SS-15 COME-00 OMB-01 XMB-02 AID-05 FRB-03
SP-02 /054 R

DRAFTED BY TREAS:OASIA:J.GIANOLA
APPROVED BY ARA/AND:ASC FULLER
STATE:ARA:AND:A.S.C.FULLER
TREAS/IDB:S CROSS (DRAFT)
----------130675 031346Z /47
R 021958Z NOV 77
FM SECSTATE WASHDC
TO AMEMBASSY LIMA

C O N F I D E N T I A L STATE 262351

E.O. 11652: GDS

TAGS: EFIN, PE

SUBJECT: PERU'S STAND-BY AGREEMENT

1. SUMMARY: ON WEDNESDAY, OCTOBER 26, A MEETING WAS HELD AT THE IMF TO BRIEF ERNEST PREEG (DEPARTING FOR LIMA TO BE DCM) ON THE PERUVIAN STAND-BY AND TO FOLLOW UP CONVERSATIONS TREASURY OFFICIALS HAVE HAD WITH THE PERUVIANS. LINDA KOENIG, THE LEADER OF THE IMF TEAM WHICH NEGOTIATED THE STAND-BY WITH PERU, BRIEFED US ON THE STATUS OF THE AGREEMENT AND THE IMPORTANT ASPECTS OF THE STABILIZATION PLAN, AND SHARED HER THOUGHTS ON THE PROSPECTS FOR THE PROGRAM. ACCORDING TO MS. KOENIG, THE AGREEMENT SHOULD BE FINALIZED WITHIN THE NEXT FEW WEEKS. SHE SAID THE STABILIZATION PROGRAM IS A DEMANDING ONE WITH "LITTLE SAFETY MARGIN." SHE SAID PERU WILL BE ABLE TO COVER ITS 1977 FINANCIAL GAP BUT,INTHE STAND-BY PROGRAM, IT IS ESTIMATED PERU WILL HAVE A $100 MILLION
CONFIDENTIAL

PAGE 02 STATE 262351

UNFINANCED GAP IN THE FIRST HALF OF 1978. END SUMMARY.

2. IN ADDITION TO MR. PREEG AND MS. KOENIG, PARTICIPANTS WERE: SAM CROSS, U.S. EXECUTIVE DIRECTOR AT IMF; RON MYERS, ASSISTANT TO MR. CROSS; A.S.C. FULLER, PERU DESK OFFICER AT STATE; AND JILL GIANOLA, PERU DESK OFFICER AT TREASURY.

3. MS. KOENIG BEGAN BY STATING THAT PERU HAD RECENTLY FREED THE EXCHANGE RATE AND IN THIS WAY HAD FULFILLED THE

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

REMAINING CONDITION FOR A STAND-BY AGREEMENT. SHE EXPECTED THE IMF PAPER ON THE STAND-BY TO BE ISSUED WITHIN THE WEEK AND THE AGREEMENT HAS BEEN PLACED ON THE IMF BOARD AGENDA FOR NOVEMBER 18. MS. KOENIG SAID THE GOP CLAIMED IT WAS NOT INTERVENING TO SUPPORT THE EXCHANGE RATE AND SHE NOTED THAT THE GOP DOES NOT REALLY HAVE FOREIGN EXCHANGE WITH WHICH TO INTERVENE. IN ANY CASE, SOMEONE FROM THE IMF WAS GOING DOWN TO PERU SOON TO INVESTIGATE HOW THE FLOATING OF THE SOL IS BEING CARRIED OUT.

4. MS. KOENIG SAID THE DEVALUATION OF THE SOL WHICH HAD OCCURRED AS A CONSEQUENCE OF THE FLOAT HAD BEEN SMALLER THAN MANY HAD EXPECTED (THE EXCHANGE RATE WAS MOVING AT ABOUT ONE SOL PER DOLLAR PER DAY). SHE OFFERED SEVERAL POSSIBLE EXPLANATIONS FOR THIS: (1) DUE TO LICENSING REQUIREMENTS, IMPORTS ARE DETERMINED 180 DAYS IN ADVANCE SO THERE IS A TIME LAG BEFORE FOREIGN TRADE SUPPLY AND DEMAND FACTORS AFFECT THE EXCHANGE RATE; (2) CREDIT IS VERY TIGHT IN PERU NOW; (3) PERU'S BALANCE OF PAYMENTS TRADITIONALLY SHOWS A SURPLUS IN THE FOURTH QUARTER; (4) THE FREEING OF THE SOL CAME AS A SURPRISE SO REACTION HAS BEEN SLOWER; (5) THERE ARE RESTRICTIONS ON CAPITAL FLOWS.
CONFIDENTIAL

5. MS. KOENIG SAID PUBLIC REACTION IN PERU TO THE STAND-BY ARRANGEMENT HAS BEEN MUCH MORE MODERATE THAN LAST SUMMER; SHE KNEW OF NO PUBLIC OUTBURST AGAINST THE PROGRAM SO FAR. SHE SAID A POSSIBLE EXPLANATION IS THAT THE GOP DID NOT RAISE THE PRICE OF REGULAR GASOLINE OR FOOD PRICES THIS TIME, OR PERHAPS THE GOVERNMENT HAS MORE POWER THAN WAS THOUGHT.

6. FINANCIAL GAP. MS. KOENIG THEN TALKED ABOUT PERU'S PROJECTED FINANCIAL GAP FOR THE REST OF 1977 AND FOR 1978. PERU SHOULD HAVE A BALANCE OF PAYMENTS SURPLUS FOR THE REST OF 1977 AND SHOULD EVEN GAIN RESERVES IN THE FOURTH QUARTER. IF NET RESERVES DO NOT INCREASE IN THE FOURTH QUARTER, IT WOULD BE EITHER BECAUSE THE GOP IS INTERVENING IN THE FOREIGN EXCHANGE MARKET OR COMMERCIAL BANKS' LIABILITIES WERE BEING INCREASED. SPECIFIC CEILINGS ON THE GOVERNMENT BUDGET AND THE BALANCE OF PAYMENTS HAVE

BEEN SET. (NOTE: WE ARE FOLLOWING UP WITH THE IMF TO DETERMINE WHAT THE CEILINGS ARE.) THE STAND-BY PROGRAM ASSUMES THAT ANY GENERAL BALANCE OF PAYMENTS SUPPORT THAT PERU GETS (E.G., PL 480, A PROGRAM LOAN FROM THE IBRD, BANK CREDIT BEYOND THAT PROJECTED) COULD NOT BE USED TO INCREASE EXPENDITURES BUT WOULD HAVE TO BE ADDED TO RESERVES. THE IMF STIPULATED THIS CONDITION BECAUSE, ON THE ONE HAND, IT DID NOT WANT TO GIVE THE GOP ANY INCENTIVE TO BORROW MORE IN ORDER TO SPEND MORE,

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

BUT, ON THE OTHER HAND, THE IMF DID NOT WANT TO DENY
PERU THE OPTION OF BORROWING IN ORDER TO BUILD UP RESERVES.

7. MS. KOENIG NOTED THAT IT WILL BE DIFFICULT FOR THE
IMF TO ACCURATELY MONITOR EVERY LOAN PERU RECEIVES, BUT
THEY WILL BE KEEPING A CLOSE WATCH ON THE SITUATION
IN ORDER TO DETERMINE IF PERU'S BORROWING IS CONSISTENT
WITH THE TARGETS SPECIFIED IN THE STAND-BY AGREEMENT.
CONFIDENTIAL

PAGE 04 STATE 262351

8. DURING THE FIRST HALF OF 1978, PERU IS EXPECTED TO
HAVE A $100 MILLION UNFINANCED GAP (APPROXIMATELY $60
MILLION DURING THE FIRST QUARTER AND $40 MILLION IN THE
SECOND). IN ADDITION, THE STAND-BY PROGRAM IS BASED ON
TWO ASSUMPTIONS: (1) ALL SHORT-TERM DEBT FROM COMMERCIAL
BANKS WILL BE ROLLED OVER. IF THESE LOANS ARE NOT ROLLED
OVER, PERU IS IN TROUBLE BECAUSE IT OWES OVER $1 BILLION
IN SHORT-TERM DEBT. ALTHOUGH THERE ARE INDICATIONS
THAT SOME OF THE SMALL BANKS WILL CALL IN THEIR SHORT-
TERM LOANS TO PERU, IT IS EXPECTED THAT THE LARGE BANKS
WILL PICK UP THE SLACK. (IN CONNECTION WITH THIS,
MS. KOENIG SAID SHE HAS RECEIVED "HUNDREDS" OF PHONE
CALLS FROM COMMERCIAL BANKS, BUT SO FAR SHE HAS BEEN
RELATIVELY RETICENT ABOUT COMMENTING ON THE SITUATION IN
PERU.) (2) PERU WILL GET $100 MILLION IN NEW MONEY FROM
THE COMMERCIAL BANKS (I.E., ABOVE THE BANKS' CURRENT
EXPOSURE IN PERU) DURING THE SECOND HALF OF 1978.

9. MS. KOENIG SAID CITIBANK TOLD HER PERU WAS CURRENTLY
NEGOTIATING A $250 MILLION LOAN PACKAGE FROM COMMERCIAL
BANKS. IF PERU OBTAINED THAT MONEY, THE $100 MILLION
GAP WOULD BE FINANCED AND PERU WOULD BE ABLE TO PAY JUST
ABOUT ALL THE APPROXIMATELY $170 MILLION IT WILL OWE IN
AMORTIZATION PAYMENTS ON MEDIUM-TERM DEBT IN 1978.
HOWEVER, THERE COULD STILL BE A TIMING PROBLEM WHICH
WOULD COMPLICATE THE FINANCING OF THE GAP.

10. MS. KOENIG BELIEVES THE $200 MILLION FIGURE THE
PERUVIANS CITED AS THE GAP IN THEIR CONVERSATION WITH
U.S. TREASURY OFFICIALS WAS QUESTIONABLE.

11. PROSPECTS OF THE PROGRAM. MS. KOENIG SAID THE PROGRAM
CONFIDENTIAL

PAGE 05 STATE 262351

AGREED TO IN CONNECTION WITH THE STAND-BY IS A VERY DEMAND-
ING ONE WITH VERY LITTLE SAFETY MARGIN. THE PROGRAM IS
BASED ON A "VERY REASONABLE FISCAL EFFORT" BY THE
PERUVIANS. SHE EMPHASIZED THAT PERU CANNOT AFFORD NOT TO
MEET THE TARGETS. SHE CHARACTERIZED THE ASSUMPTIONS
UNDERLYING THE PROGRAM AS "REASONABLY CONSERVT BUT A

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

LOT WORSE COULD HAPPEN". PERU'S RESERVES SHOULD START RECUPERATING DURING THE THIRD QUARTER OF 1978. SHE ADDED THAT FROM WHAT IBRD OFFICIALS HAD TOLD HER, THERE IS NOT MUCH CHANCE THAT THE IBRD WOULD GRANT PERU A PROGRAM LOAN.

12. WHEN SAM CROSS ASKED HER HOW THE IMF COULD AGREE TO A STAND-BY PROGRAM WHICH INCLUDED A $100 MILLION UNFINANCED GAP, MS. KOENIG REPLIED THAT TO HAVE GOTTEN ANY MORE OUT OF THE PERUVIANS WOULD HAVE BEEN "ILLUSORY" BECAUSE THE PERUVIANS ARE NOT ABLE TO DELIVER MORE. SHE NOTED THAT SHE AND OTHER MEMBERS OF THE IMF TEAM HAD GONE TO PERU NINE TIMES IN THE LAST TWO YEARS TO NEGOTIATE A STAND-BY AND SHE FEELS THE PROGRAM IS THE BEST THE PERUVIANS CAN DO.

13. REGARDING THE STAND-BY AGREEMENT ITSELF, MS. KOENIG SAID IT IS NOT AN EXTENDED FUND FACILITY ARRANGEMENT. THE ST;;DBY WOULD LAST THROUGH DECEMBER 1979 AND WOULD TAKE PERU JUST INTO THE FOURTH CREDIT TRANCHE UNDER THE OLD QUOTA OR INTO THE THIRD CREDIT TRANCHE UNDER THE NEW QUOTA. THE STAND-BY IS FOR 90 MILLION SDRS WHICH WILL BE DOLED OUT IN NINE BITES: 10 MILLION SDRS WILL BE DRAWN UPON SIGNING THE AGREEMENT, THE NEXT 10 MILLION SDRS ON FEBRUARY 28, 1978, AND 10 MILLION SDRS WILL BE DRAWN EVERY QUARTER THEREAFTER. MS. KOENIG SAID SHE ESTIMATED THAT PERU COULD CONCEIVABLY GET 50 MILLION SDRS FROM THE WITTEVEEN FACILITY DURING 1978 BUT WARNED US "NOT TO HOLD OUR BREATHS".

CONFIDENTIAL

PAGE 06 STATE 262351

14. MS. KOENIG MADE SEVERAL ADDITIONAL COMMENTS ABOUT THE SITUATION IN PERU. SHE SAID PERU'S DEBT SERVICE HAD RISEN EXPONENTIALLY IN RECENT YEARS; NEXT YEAR DEBT SERVICE IS EXPECTED TO ACCOUNT FOR 2 PERCENT MORE OF GDP THAN THIS YEAR, AND THE YEAR AFTER, IT WILL ACCOUNT FOR ANOTHER ONE PERCENT. SHE SAID PERU'S ABILITY TO SURVIVE ITS ECONOMIC CRISIS DEPENDED TO A LARGE EXTENT ON THE COOPERATION OF THE COMMERCIAL BANKS. MR. MYERS ASKED HOW THE BANKS WOULD REACT TO THE $100 MILLION UNFINANCED GAP WHICH THE STAND-BY ASSUMES. MS. KOENIG SAID THAT, IN HER OPINION, THE BANKS HAD HELPED PERU

GET INTO THE MESS AND THEY SHOULD BE WILLING TO HELP BAIL PERU OUT.

15. SHE SAID THAT DURING THE NEGOTIATIONS, THE PERUVIANS OFTEN MENTIONED THE POSSIBILITY OF OBTAINING A "SWAP" AGREEMENT WITH THE U.S. TO PROVIDE BRIDGE FINANCING. MS. GIANOLA SAID THE U.S. DID NOT INTEND TO PROVIDE BRIDGE FINANCING TO PERU AND THE PERUVIANS HAD BEEN CLEARLY TOLD

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

THAT WHEN THEY WERE HERE FOR THE BANK/FUND MEETINGS. MS. KOENIG AGREED THAT A LINE OF CREDIT FROM THE ESF, E.G., WAS NOT APPROPRIATE FOR PERU BECAUSE THE ECONOMIC CRISIS WILL NOT BE RESOLVED IN SIX MONTHS. IN HER OPINION, THE USE OF BRIDGE FINANCING HAD CAUSED SERIOUS PROBLEMS FOR PERU BECAUSE THE GOP HAD USED IT TO OVERSPEND AND THIS HAD UNDERMINED THE IMF'S EFFORT IN PERU FOR THE PAST TWO YEARS.

16. REGARDING MILITARY SPENDING, MS. KOENIG SAID THE FIGURES SHE HAD SEEN ON PERU'S ARMS EXPENDITURES WERE VERY HIGH. PERU HAD PROMISED TO "SUBSTANTIALLY" REDUCE MILI-TARY SPENDING BUT, MS. KOENIG SAID, GIVEN THE INCREDIBLE CONFIDENTIAL

AMOUNTS SPENT ON ARMS RECENTLY, SHE COULD NOT JUDGE IF A 15-20 PERCENT REDUCTION, FOR EXAMPLE, COULD BE CONSIDERED "SUBSTANTIAL". SHE NOTED THAT PERU OWED $250 MILLION FOR FIGHTER BOMBERS ALONE.

17. MS. KOENIG ALSO NOTED THAT HUNDRED OF MILLIONS OF DOLLARS IN PLANNED INDEBTEDNESS FOR 1978 HAD BEEN SHIFTED INTO 1977 AND SHE DID NOT KNOW HOW MUCH LONGER THIS COULD GO ON. IN ADDITION, SHE SAID THE GOP HAD UNDERTAKEN SOME QUESTIONABLE PROJECTS AND A COMPREHENSIVE REVIEW OF PERU'S INVESTMENT STRATEGY WAS NEEDED.

18. FOREGOING INFORMATION PROVIDED FOR BACKGROUND PURPOSES AND SHOULD BE HELD IN CONFIDENCE. VANCE

CONFIDENTIAL

<< END OF DOCUMENT >>

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009

Message Attributes

Automatic Decaptioning: X
Capture Date: 22-Sep-1999 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: AGREEMENTS, FINANCIAL STABILITY, FINANCIAL PROGRAMS
Control Number: n/a
Copy: SINGLE
Sent Date: 02-Nov-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977STATE262351
Document Source: ADS
Document Unique ID: 00
Drafter: TREAS:OASIA:J.GIANOLA
Enclosure: n/a
Executive Order: 11652 GDS
Errors: n/a
Expiration:
Film Number: D770405-0292
Format: TEL
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t197711116/baaaeuey.tel
Line Count: 251
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, TEXT ON MICROFILM
Message ID: 713b1a10-c288-dd11-92da-001cc4696bcc
Office: ORIGIN TRSE
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 18-Apr-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 426379
Secure: OPEN
Status: NATIVE
Subject: PERU\'S STAND-BY AGREEMENT
TAGS: EFIN, PE, IMF
To: LIMA
Type: TE
vdkvgwkey: odbc://SAS/SAS.dbo.SAS_Docs/713b1a10-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009